

COMMERCIAL REAL ESTATE

Avoiding Transaction Pitfalls

where developers go wrong when they go it alone

By Misha Rabinowitch, Robert Inselberg, Joseph Kremp, Samantha Hargitt, and Danielle Waltz

Getting to the proverbial “closing table” is not as easy as it looks. Every commercial real estate transaction comes with ups and downs and unexpected challenges. Overcoming potential hurdles, as outlined in this article, can minimize common pitfalls in a transaction.

THE LETTER OF INTENT

Many transactions begin with a letter of intent. Letters of intent should be comprehensive and include all pertinent deal terms. Although typically non-binding, most letters of intent include limited binding provisions such as confidentiality and exclusivity. You should thoughtfully identify binding and non-binding provisions. Allowing legal counsel to review draft letters of intent often leads to more effective and efficient negotiation.

THE PURCHASE AGREEMENT

Bare ground purchase agreements negotiated by do-it-yourself (DIY) developers without the assistance of legal counsel often lack fundamental protections.

THE FREE LOOK

Immediately non-refundable earnest money is almost always a mistake. A developer should expect a reasonable inspection period to investigate the physical condition of the property without any risk of losing its earnest money. If the developer decides not to pursue the project during this period for any reason, it should be entitled to walk away and receive a full refund.

WHEN THINGS GO SOUTH

One grave error we see DIY developers make is agreeing to allow a seller to pursue all available remedies in the unfortunate event the developer defaults. A seller’s remedy should always be expressly limited to earnest money as liquidated damages. Agreeing to all available remedies gives the seller the right to sue for damages beyond the earnest money, perhaps even damages equating to its lost benefit. Those damages could be substantial.

THE SELLER DEFAULT—OUT-OF-POCKET RECOVERY

The common starting point in the event a seller defaults under a bare ground purchase agreement is a Door A/Door B decision. The developer has two options: Ask a court to force the seller to perform, known as specific performance (Door A), or opt to terminate the purchase agreement and receive a refund of earnest money (Door B). The latter is where the DIY developer sometimes goes wrong. The developer may have high dollar amounts invested in predevelopment expenses prior to default. The developer should always push to recover at least a portion of those expenses.

DUE DILIGENCE

Appropriate due diligence varies for every deal. However, the analysis of real estate should typically include a review of title and survey, environmental reports, zoning and property condition reports, leases, services contracts, and other agreements effecting the nature and operation of the subject property. Agreements

with short inspection periods should be avoided when reliant upon third party reports, which may have unpredictable delivery times.

FINANCING

The capital stack for a deal may include multiple layers, which can change due to a variety of circumstances, but debt and equity generally remain constants. Including legal counsel when negotiating and finalizing joint-venture or other equity and loan documentation can be particularly important when it comes to negotiating the rights a developer will have if the deal goes south or encounters other unexpected challenges. Some of the most common key provisions that cause friction in debt and equity relationships are responsibility for major decisions, cost overruns, manager removal, and guaranty obligations. Effective legal counsel will help negotiate a middle ground on many of these items and make sure the developer makes informed choices about the risks of not pushing for the middle ground.

CLOSING COORDINATION

Thoughtful closing coordination is an essential component of getting deals done. Keeping legal counsel in the loop throughout a transaction helps ensure they know the cast of players and can help the developer and its team identify critical path items and consolidate informational requests from multiple parties. Developers can also leverage the administrative resources of a law firm to track original documents, coordinate notaries, and manage deliveries to parties like escrow agents or title companies. ■

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